SPRING 1996 VOL. II NO. 2

NOLHGA JOURNAL

A PUBLICATION OF THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS

Fallout From IRC 7702 Policies Raises Thorny Questions

By KEVIN GRIFFITH
Baker & Daniels

Prior to the development of universal life insurance, there was a fixed relationship among premiums, cash values and face amounts of traditional life insurance products. With the advent of universal life, policyholders could pay what they wanted, when they wanted. According to the record of the Society of Actuaries' October, 1994 meeting, "there was a heated controversy...[over] whether universal life would receive favorable tax treatment under the IRC. At that time, the industry made a bargain with Congress to sacrifice the tax treatment of some products, including short-term endowments and some forms of single-premium life, for the certainty of Section 7702."

The possible non-compliance of an insolvent company's policies with Internal Revenue Code Section 7702 may not be a direct burden on the guaranty associations, analysis shows, although a settlement paid by the liquidator to the Internal Revenue Service would reduce guaranty association recoveries.

IRC Section 7702

Section 7702 limits the investment orientation of life insurance policies for tax purposes. If a policy qualifies as life insurance under the code, taxes on the policy's internal cash build-up are deferred until the policy is surrendered. Section 7702 addresses both the maximum amount of premium that a policyholder may put into a life insurance policy and the ratio that must be maintained between a policy's death benefit and its cash value. Guidelines of Section 7702 are based on factors including the age of the insured and the interest rate and mortality charges under the policy.

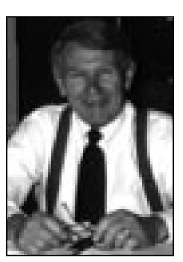
If a policy violates these guidelines, the policyholder is subject to income tax each year on the income on the policy. Once a policy fails to comply with Section 7702, all income, from the date the policy was issued until the year it failed, becomes taxable in the year of failure.

See Section 7702, *Page 4*

Interstate Compact Commission Could Pave Way for Uniform Rehabilitation, Liquidation Rules

By JACK H. BLAINE
President
NOLHGA

Feb. 8, 1996, may be recorded as a milestone along the path of interstate compacts for insurance company receiverships. That was the day the new commission, created by enactment of the compact in four states, held its inaugural meeting in Chicago. The four states are California, Illinois, Nebraska and New Hampshire.



It was recently called to my attention that the notion of an interstate compact for insurance insolvencies first came up almost 20 years ago. The late Max Wallich, former Washington, D.C. superintendent of insurance, suggested at a Dec. 6, 1977 meeting of the NAIC's Insurance Guaranty Fund Subcommittee that interstate compacts be considered as an adjunct to effective administration of the rehabilitation and guaranty fund acts. More recently, our own NOLHGA vice chairman, James M. Jackson, caught the attention of state legislators and regulators with a paper he wrote on the subject and speeches he made in a number of forums. Jim probably is more closely identified with the present-day compact than anyone else in the industry, although a number of other people have written papers on the subject. In fact, there is a substantial body of literature available on interstate compacts

See Blaine, *Page 2*

Inside

- INTERVIEW
  Chairman Lawrence F. Harr
  Page 3
- CASE STUDY
  Mutual Benefit Life
  Page 5
- A DAY IN THE LIFE...
  Daniel A. Orth III (Illinois)
  Page 6

President's Column

Blaine, *from Page 1*

for the regulation of insurance, and for the handling of insurance receiverships specifically.

As an observer at the commission's first meeting, I felt a sense of history in the making for several reasons:

- the commission representatives present and their staffs had done a commendable job in preparing for the meeting -- Nebraska Director Lange had prepared a list of statutory requirements of the compact and suggested a timetable for accomplishment;

- Illinois Special Deputy Receiver Peter Gallanis had prepared a draft set of bylaws;

- financial estimates for the first year of operation had been prepared; and

- an agenda had been well thought out. This created an atmosphere of confident efficiency, and consequently, I think others in the audience may have shared my sense that this new creature really is going to succeed.

We in the state guaranty association business should not only be prepared to work with the new commission and staff, but to do whatever we can to make the compact work. Let me repeat some of the potential advantages of the compact: the commission can impose consistent, uniform rules on rehabilitations and liquidations of insurance companies; compacting states will be able to obtain current information on each insolvency and, depending on the regulations adopted, assert the right to have a voice in liquidation and asset disposition processes.

State guaranty associations could gain much from the compact by way of better oversight by the commission, more prompt resolution of insolvencies and better accountability of estate assets.

If a large number of states join the receivership compact in the next three years (e.g., 20 or more), it will have real momentum and a permanent life. Success of the receivership compact may also lead to proposals for expansion to include guaranty associations, or a separate compact for guaranty associations. I wouldn't venture a prediction on whether the latter will happen; certainly, there are strong arguments against the need for a guaranty association compact as became evident when they were dropped from an earlier draft and the current compact became one for receiverships only. How well the guaranty associations and NOLHGA work with the current compact commission on insolvencies may also be a major consideration. ▼

NOLHGA JOURNAL

Vol. II No. 2

Spring 1996

The NOLHGA *Journal* is a publication of the National Organization of Life and Health Insurance Guaranty Associations dedicated to examining issues affecting the life and health insurance guaranty system.

Copyright © 1996

All Rights Reserved

National Organization of Life and Health Insurance Guaranty Associations

Reproduction in whole or part is authorized with attribution to:

NOLHGA
13873 Park Center Road
Suite 329
Herndon, VA 22071

Tel.: 703/481-5206
FAX: 703/481-5209

E-Mail Address:
LisaM0503@aol.com

Managing Editor Lisa M. Meyer

NOLHGA News

Web Site Launched

NOLHGA unveiled in January its home page on the World Wide Web. NOLHGA*Net*, accessible by member guaranty associations, their boards, and others in the guaranty system and regulatory community, includes NOLHGA publications, basic information about the organization, a calendar of events and an e-mail directory. Other features are being developed. To visit the site, call Marcy Dausch at 703/318-1163 for a password. The NOLHGA*Net* address is http://www.nolhga.com. ▼

Publications Available

NOLHGA's *Report to the Membership,* published in January, includes summaries and financial information of active cases and a synopsis of committee activities. To request a copy, please call NOLHGA at 703/481-5206. Also in January, NOLHGA distributed its *Insolvency Financial Reports.* Vol. I contains data by insolvency and Vol. II contains data by state. This report is available to guaranty association administrators and board members. ▼

Interview

NOLHGA Chairman Lawrence F. Harr

Q As one who has served on your state guaranty association's board for several years, what do you see as the primary accomplishments of the state guaranty associations in recent years?

NOLHGA Chairman Larry Harr

A Of course, 1991 was the year that the life insurance industry saw unprecedented insolvencies, both in number and size. Two of the largest life insurance company insolvencies in history -- Executive Life Insurance Company of California and Mutual Benefit Life -- shocked both the life insurance industry and the state guaranty system. These failures came when the state system was in the midst of changing to a "residents only" basis for coverage and there was little precedent for handling large, multi-state insolvencies like ELIC and MBL. We also had over 20 other companies go into receivership that year. Working toward a solution for these huge insolvencies was one of our major achievements. During Congressional hearings that followed the ELIC and MBL insolvencies, there was great skepticism as to the ability of this state system to handle the challenge. Looking back, I think all those involved -- from NOLHGA task forces and guaranty association administrators to state boards and insurance companies -- can take a bow and say "we told you we could do it and we did." Some of the same critics now say it took too long to resolve, but any bankruptcy with liabilities the size of some of these companies is going to generate litigation and other delays as solutions are negotiated. The lessons learned from those insolvencies have helped the system do a better job on the more recent ones.

Q Is the system better positioned to address today's challenges?

A Clearly it is. Not only have we a track record on dealing with the huge insolvencies, we have a system in place that has a number of experienced people involved, starting with the NOLHGA staff and including the administrators and legal counsel in the various states. In 1991, we had neither the experience nor the expertise on the association staffs that we have now. Today we are not faced with the multitude of new life insurance company failures that we experienced three and four years ago. Of course, we are still involved heavily in resolving the earlier insolvencies, including the Confederation Life Insurance Company failure in 1994. Litigation arising out of ELIC and other insolvencies is still consuming sizeable resources, as is the implementation of the plans put into effect in 1993. The guaranty associations are also addressing the critical issue of recovering assets from outstanding estates. There are millions of dollars still in estates. The guaranty associations are, by far, the largest creditors and they have an obvious interest in getting those monies back as soon as possible.

Q What is your primary goal as NOLHGA chair?

A The NOLHGA Board of Directors began the year with a full-day session on strategic planning. That process, a continuation of the one begun in 1992, will hopefully result in adoption of an updated strategic plan at our next meeting in April. I would like us to adopt and implement a plan making NOLHGA and its members capable of confronting challenges. An ideal plan would involve many aspects of the guaranty association system: seeking an optimum level of resources that will allow the states to be ready for a repeat of 1991, and at the same time be flexible enough to shift resources and priorities during temporary lulls in new insolvencies like we are now experiencing; preparing for the rapid changes in the insurance industry environment that will impact the guaranty system, such as the recent movement of banks into the sale of insurance products, and perhaps the underwriting of insurance in the future, or the fundamental changes in the health insurance/health care industry; being able to bring insolvent insurers' estates to resolution more rapidly; and finally, anticipating what changes the advent of interstate compacts will have on the guaranty system.

See Q & A, *Page 10*

"...I think all those involved -- from NOLHGA task forces and guaranty association administrators to state boards and insurance companies -- can take a bow and say, 'we told you we could do it and we did.' "

Section 7702, *from Page 1*

The taxable income is calculated as A + B - C, where A = increase in net surrender value during the taxable year; B = cost of life insurance protection during the taxable year; C = premiums paid during the taxable year. Interest accrues from the year of failure until the taxes are paid. In cases of non-compliance, which invite penalties, the insurer must provide to the affected policyholders by Jan. 31, and file with the IRS by Feb. 29, forms 1099 that disclose the taxable income for the prior tax year.

There are two likely solutions to the problem. If the errors which caused the policies to fail were "reasonable," the IRS may waive the tax consequences. If the errors are not considered reasonable, the IRS may assess a "toll charge" against the company before consenting to treat the policies as life insurance. Toll charges, paid by the company in lieu of penalties the IRS could otherwise seek to impose, consist of all taxes due from the policyholders for all tax years, with interest. Since the toll charge does not technically pay the taxes on the policy's income, the policyholders' tax obligation upon a later surrender of the policy is not reduced.

"Under the U.S. Supreme Court Fabe decision, states are permitted to give priority to policyholders over government claims. Payment to the federal government ahead of policyholders would violate that priority at the expense of the guaranty associations."

A company's payment of a toll charge allows the failed policies to be treated as life insurance for tax purposes and, therefore, eliminates the policyholders' current tax obligations. This also eliminates all other tax penalties the IRS could impose on the company. Other penalties include a potential $25 per day per policy charge for the company's failure to file 1099 forms with the IRS. The maximum failure-to-file penalty is $15,000 per policy per tax year. The company is exposed to new tax penalties for each tax year it failed to file the 1099s. A company with 1,000 failed polices that did not file 1099 forms with the IRS would be exposed to a potential liability of $15 million for each tax year. If all these policies had been out of compliance for five years, that would subject the company to $75 million in tax penalties.

Regardless of whether the errors were reasonable (penalties and taxes waived) or unreasonable (full toll charge paid), the company must refund the excess premiums it received, with interest, or increase the policies' death benefits, before the IRS will consent to treating the policies as life insurance.

Guaranty Association Liability

An insolvent insurer with policies that failed the 7702 test could cost guaranty associations money, even though policyholders' tax liabilities or losses unrelated to an insurer's insolvency are not covered. With a green light from the IRS, a liquidator may try to re-qualify failed policies as life insurance and place them in the market. For its part, the IRS will insist on a full toll charge for 7702 failures that were not caused by reasonable errors. To fund a toll charge, the liquidator may tap the insurer's general assets, which hurts all policyholders, or he may try to use assets otherwise spoken for and, at the same time, reduce those policies' cash values. Either option is a bad deal for guaranty associations and policyholders, because estate assets -- assets needed to cover policyholder liabilities -- would take a hit. Reducing the insurer's general assets to pay a government claim violates most priority statutes. Under the U.S. Supreme Court Fabe decision, states are permitted to give priority to policyholder claims over government claims. Payment to the federal government ahead of policyholders would violate that priority at the expense of the guaranty associations. ▼

Willis B. Howard Jr., NOLHGA senior vice president and actuary, and Lisa M. Meyer, manager, industry communications, contributed to this article.

Case Study

Restoring MBL Policyholders' Values Tops Priority List of Commissioner, NOLHGA

By Richard W. Klipstein
Executive Vice President, Insurance Services
NOLHGA

No one was ready for the fall in 1991 of the giant, well respected, old-line New Jersey insurer, Mutual Benefit Life. There were no case studies of what to do when a $13 billion company is unable to pay its obligations and is taken over by the insurance commissioner. Best case, under a traditional liquidation, was a $4 billion hole, meaning that certain policyholders would have lost almost half the value of their contracts. Even after a reinsurance transaction for about $5 billion and protection from the state guaranty associations for another $4 billion, there would still have been a $2 billion hole.

For Samuel Fortunato, New Jersey's insurance commissioner at the time, coming close wasn't good enough. His objective was to restore full account values to all Mutual Benefit policyholders. The problem was, no one knew how to do this. So Fortunato took an active role in overseeing the rehabilitation. He moved quickly and hired a skilled team of professionals with the track record to handle a real estate workout of this magnitude. He immediately encouraged NOLHGA and major companies in the insurance industry to participate in the initial financial analysis and to work with the receiver resources in forging a solution to maximize the value of the assets and preserve policyholders' benefits.

The receiver's team, led by Victor Palmieri of the Palmieri Co., the industry advisory group led by Bob Chmely of the Prudential and NOLHGA led by Art Dummer of the Utah guaranty association, worked to understand the many complex and intertwined issues. With the knowledge they gained, a plan was shaped that would meet the commissioner's objectives and withstand the close scrutiny of the courts. The plan also had to draw the support of 49 affected guaranty associations, 52 insurance commissioners, key insurance companies, and policyholder groups representing a myriad of different types of policyholders, often with conflicting objectives and interests.

We are still three years away from end of the rehabilitation plan period, and there is, quite naturally, some lingering uncertainty regarding the outcome. However, it is very clear that so far, the the plan is working. Since the closing two years ago, the restoration of policyholder benefits and values has taken a giant leap forward. Although policyholders do not have unrestricted access to their cash, all life insurance death benefits, health insurance, disability income and annuity benefits are being paid in full. For the majority of policyholders the annual interest crediting rates on their contracts, since 1991, continue to average approximately 5 percent. The growth in the company's capital and surplus and the conversion of the real estate holdings to investment grade bonds, which are both critical to the overall success of the plan, are well ahead of schedule. Even for the large, sophisticated buyers of MBL's Guaranteed Investment Contracts (GICs) there is considerable financial evidence that full values, plus interest, will be returned. The sacrifice will have been temporary loss of full access to the contract values, and some reduction in annual earnings on their funds. These policyholders in particular helped MBL immensely by working towards a reasonable solution which minimized litigation costs and furthered the estate's ability to maximize value from the troubled assets for the benefit of all policyholders.

Intrinsically, the flexibility in a system of state insurance regulations made possible the creative solution to the MBL case. Unlike a federal system, the checks and balances of the 52 insurance departments and guaranty associations that may be involved in a multi-state insolvency, help to avoid costly mistakes. Unfortunately, that same system, without extreme care, can just as easily languish in bureaucracy, become ineffectual and costly and ultimately, not serve the policyholders, raising questions as to whether a federal system would be better.

MBL is but one example, perhaps the best because of size and complexity, that demonstrates that this system, without amending

See MBL, *Page 10*

For Samuel Fortunato, New Jersey's insurance commissioner at the time, coming close wasn't good enough. His objective was to restore full account values to all Mutual Benefit policyholders.

Robert M. Chmely is president, guaranteed products and retirement, Prudential Insurance Company of America. Arthur O. Dummer, FSA, FCA, MAAA, is managing secretary of the Utah guaranty association and is a consulting actuary with the Donner Company. Victor Palmieri is chairman and CEO of The Palmieri Company.

A Day in the Life of a Guaranty Associa

Daniel A. Orth III has been the executive director of the Illinois Life and Health Insurance Guaranty Association and the Illinois Health Maintenance Organization Guaranty Association since 1993. Prior to this, he was in-house counsel for Washington National Insurance Company for 27 years. In addition to serving on NOLHGA's MPC Executive Committee, Mr. Orth also chairs or is a member of many NOLHGA task forces (see box at right). He has served on NOLHGA's board of directors and on the boards of the Illinois and Oregon guaranty associations.

NOLHGA Director William A. Wilson and Dan Orth share a laugh during a break at September's MPC meeting in Orlando, Fla.

Mr. Orth received his degree in accounting and finance from Marquette University and his Juris Doctor degree from Northwestern University School of Law.

Following are excerpts from Mr. Orth's date book during the week of Jan. 29.

MONDAY, JAN. 29

9 am - Kentucky Central teleconference; approved proposed amendment to the participation agreement.

10 am - Kentucky Central Working Group/Real Estate teleconference; discuss outline for meeting with realtor.

Late morning - Sue seeks signatures on check requisitions; Linda and Dan review draft of tax offset notice to be mailed to HMOs.

12:30 pm - Staff gathers for lunch.

1 pm - American Integrity teleconference.

2 pm - Meeting with attorney representing the association on an ELIC matter before the Illinois director of insurance.

2:15 pm - Call to Tony Buonaguro, NOLHGA's executive vice president and general counsel.

Later that afternoon - Spend time with Kathy reviewing mail and putting finishing touches on the association's annual report to be sent to the director of the Illinois Department of Insurance.

Dan Orth confers with Robert F. Ewald, who h
and other states. Mr. Ewald is past chairman

TUESDAY, JAN. 30

9 am - Barbara and Dan discuss questions raised at the association's recent audit.

10 am - Debbie and Dan discuss coverage questions presented to the association by several ELIC policyholders.

11 am - Confederation Life tele-

Debbie Orth, policyholder service/office assistant; Sue Tangorra, accountant; Dan Ort
ment manager; Kathy Sieczko, administrative assistant; and Barbara Clarke, controlle
near O'Hare International Airport. All staffers except for Dan and Kathy are part-time.

...tion Administrator

...as designed an assessment system for Illinois
...of the Members' Participation Council.

conference; discuss revised draft of NOLHGA's plan, including a solution for structured settlements.
1:45 pm - Depart for O'Hare Airport for flight to New Orleans.
8 pm - attend meeting in New Orleans with NOLHGA Communications Committee.

...n, executive director; Linda Ignoffo, assess-
..., prepare for a teleconference at their offices

WEDNESDAY, JAN. 31

8 am - 2 pm - Attend NOLHGA Communications Committee meeting in New Orleans.
2:15 pm - Call Kathy at Illinois guaranty association office for an update on the day's events.
2:30 - 5:30 pm - Review materials for next two days of meetings.
5:30 pm - Depart New Orleans for Philadelphia, en route to Wilmington, Del. for National Heritage meeting. Continue reviewing materials during flight.
11:15 pm - Arrive in Wilmington, Del.

THURSDAY, FEB. 1

8 am - Meeting with National Heritage Working group to prepare for meeting with receiver.
10 am - Meet with receiver to discuss details of assumption reinsurance transaction, liquidating trust and ceding fee.
1 pm - Meet with litigation subcommittee and receiver's litigation counsel.
3 pm - Take Metroliner from Wilmington, Del. to New York City; prepare on train for next day's meeting.
6 pm - Arrive in New York City.
8 pm - Meeting with National Heritage Working Group.

FRIDAY, FEB. 2

8:30 am - Meeting with National Heritage Working Group.
10 am - Meet with Metropolitan Life, the assumption reinsurer of more than 24,400 policies of the failed National Heritage.
2 pm - Call office; speak with Debbie and Kathy to get updates and answer questions.
3 pm - Fly from New York to Chicago.
7 pm - Arrive home in Chicago. ▼

Road Warrior: Dan Orth checks his ticket before boarding a flight to New Orleans, where he will attend a meeting of the NOLHGA Communications Committee. O'Hare International Airport is just 10 minutes from the Illinois guaranty association's offices.

DAN ORTH'S INSOLVENCY TASK FORCES

National Heritage Life Insurance Co. (*chair*)

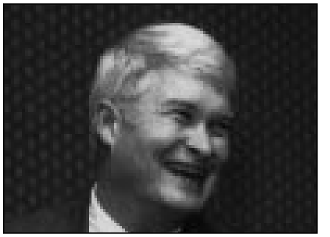
American Integrity Insurance Co.
Confederation Life Insurance Co.
Executive Life Insurance Co.
First Capital Life Insurance Co.
Fidelity Bankers Life Insurance Co.
George Washington Life Insurance Co.
Inter-American Life Insurance Co.
Kentucky Central Life Insurance Co.
Supreme Life Insurance Co.

COMMITTEES

Communications Committee
Incorporation Steering Committee
MPC Executive Committee

The Illinois Life and Health Insurance Guaranty Association has been a member of NOLHGA since the latter's inception in 1983. Mr. Orth says the Illinois association believes strongly in the benefits to be derived from working closely with its sister associations. He adds that upon the occurrence of a multi-state insolvency, it is helpful for the states to share information, compiled from task force efforts, with a high degree of confidence. Mr. Orth says that he has been continuously gratified to work with the superb professionals who comprise the guaranty system in the United States, from administrators who protect the interests of their policyholders; their individual board members; and knowledgeable professional consultants.

JEAN C. HASCH



MARK H. FEMAL

DOUGLAS C. FURLONG

DONNA T. MUNDY

WILSON D. PERRY

1996 NOLHGA COMMITTEES

ACCOUNTING MODEL TASK FORCE

Jean C. Hasch, Chair
Maine Guaranty Association

Michael D. Blinson
North Carolina Guaranty Association

Marvin Coffman
Texas Guaranty Association

Mark H. Femal
Wisconsin Guaranty Association

Henry Grimes
Florida Guaranty Association

Jamie Kelldorf
Colorado Guaranty Association

Michael Marchman
Georgia Guaranty Association

Mark Might
Ohio Guaranty Association

Charles F. Renn
Missouri Guaranty Association

Paul A. Peterson
NOLHGA Staff Contact

ADMINISTRATORS' EDUCATION STEERING COMMITTEE

Mark H. Femal, Chair
Wisconsin Guaranty Association

Linda Becker
Kansas Guaranty Association

Andrea H. Bowers
South Carolina Guaranty Association

Betty Olsson
Idaho Guaranty Association

Peggy Parker
Virginia Guaranty Association

Thomas E. Peterson
Kentucky Guaranty Association

Roberto Ramirez
Puerto Rico Guaranty Association

Lisa M. Meyer
NOLHGA Staff Contact

ASSESSMENT DATA TASK FORCE

Douglas C. Furlong, Chair
New Jersey Guaranty Association

William Carroll
American Council of Life Insurance

Marvin Coffman
Texas Guaranty Association

Robert Elconin
IDS Life Insurance Company

Howard H. Kayton
Security Life Insurance Company

David Nachman
Prudential Insurance Company

Charles F. Renn
Missouri Guaranty Association

James W. Rhodes
Oklahoma Guaranty Association

William D. Ward
AETNA Life Insurance Company

Micki Wilden
USG Annuity and Life Insurance Company

Paul A. Peterson
NOLHGA Staff Contact

Audit Policy Task Force

Mark H. Femal, Chair
Wisconsin Guaranty Association

James C. Beckstrom
North Dakota Guaranty Association

Marvin Coffman
Texas Guaranty Association

Dan H. Elrod
Tennessee Guaranty Association

Douglas C. Furlong
New Jersey Guaranty Association

Phillip A. Hammond
Indiana Guaranty Association

Jean C. Hasch
Maine Guaranty Association

Charles F. Renn
Missouri Guaranty Association

James W. Rhodes
Oklahoma Guaranty Association

Paul A. Peterson
NOLHGA Staff Contact

Communications Committee

Donna T. Mundy, Chair
UNUM Corporation

Nancy Amiel
The Equitable

Gerald Backhaus
Minnesota Guaranty Association

Barbara E. Bey
American Council of Life Insurance

Patricia Hillis
SAFECO

Michael Marchman
Georgia Guaranty Association

Robert Nolan
Hartford Life Insurance Company

Daniel A. Orth III
Illinois Guaranty Association

Peggy Parker
Virginia Guaranty Association

Wanda Stevens
Texas Guaranty Association

Thomas Topinka
Life Insurance Company of Virginia

Lisa M. Meyer
NOLHGA Staff Contact

Legal Committee

Wilson D. Perry, Chair
Northwestern Mutual Life Insurance Company

Lewis F. Beers III
Aetna Life & Casualty Insurance Company

Cynthia Borrelli
Bressler, Amery & Ross

Barbara C. Brown
Texas Guaranty Association

John N. Gavin
Hopkins & Sutter

Allan W. Horne
Davidson, Horne & Hollingsworth

Victor R. Marshall
Victor R. Marshall & Associates, P.C.

Franklin D. O'Loughlin
Rothgerber, Appel, Powers & Johnson

James W. Rhodes
Oklahoma Guaranty Association

Richard H. Saxe
The Prudential Insurance Company of America

Francis A. Sutherland Jr.
Jefferson-Pilot Life Insurance Company

Christopher J. Wilcox
LaFollete & Sinykin

Anthony R. Buonaguro
NOLHGA Staff Contact

Members' Participation Council Executive Committee

Frank Gartland, Chair
Ohio Guaranty Association

John C. Colpean
Michigan Guaranty Association

John J. Falkenbach
Delaware Guaranty Association

Mark H. Femal
Wisconsin Guaranty Association

Douglas C. Furlong
New Jersey Guaranty Association

Donal A. Kinney
Vice Chair, New Mexico Guaranty Association

Franklin D. O'Loughlin
Rothgerber, Appel, Powers & Johnson

Daniel A. Orth III
Illinois Guaranty Association

Peggy Parker
Virginia Guaranty Association

Dana Carroll
NOLHGA Staff Contact

Case Study

Important Lessons from the MBL Case

- Early access to the collective knowledge and experience of the industry and guaranty associations provides regulators the most effective and prudent way to restore maximum policyholder value following an insolvency.

- Early communications and continuous progress reports to policyholders and regulators are a must. Policyholders feel tremendous anxiety during the insolvency proceedings and the progress made, no matter how fast, will not be good enough. They need the truth and they need as much information as is available. Regulators must be informed so they can be supportive.

- The appointment of the deputy receiver is probably the most important decision. With leadership, the other pieces fall into place.

- Guaranty associations, working on a national level, with support from the industry, are a reservoir of knowledge. The guaranty associations can help identify the skills required to run the receivership, make recommendations regarding potential candidates who have had the appropriate experience and performance track record. The difference between today and five years ago is that the system has experience and has been tested. NOLHGA now has access to a broad array of knowledgeable resources with specialized skills who are responsive and insure that the safety net for policyholders works better than ever.

MBL, *from Page 4*

existing law, can restore considerable policyholder value and confidence by maximizing asset recoveries and making prudent use of funds from guaranty associations. The cost of insolvencies has been climbing and today absorbs approximately $1 billion per year. Thoughtful use of resources can lower these costs and preserve the insurance industry's surplus and capital, which is better spent on developing the new products necessary to remain competitive, strong and to defend itself against predators from outside the industry, such as mutual funds and banks. Ultimately, these initiatives reward all policyholders with better returns and greater financial security.

A cornerstone of the MBL rehabilitation plan was the transfer of all policyholder liabilities to a surviving company, MBL Life Assurance Co. (MBLLAC), with four of the 10 members of the new board of directors appointed by NOLHGA and the consortium of insurers. This participation in governance was undoubtedly a huge concession by the commissioner, but it was imperative if the plan was going to work. As it turned out, the life insurance expertise of the four outside directors enhanced decision-making and helped move the implementation process forward.

For MBLLAC, 1995 was a pivotal year. The board of directors, in accordance with the plan, appointed a new chief executive officer, Alan J. Bowers, formerly a managing partner with Coopers & Lybrand. By year end, general account real estate assets had been reduced to less than $2 billion, holdings in investment grade bonds had been increased to more than $5 billion and an accelerated real estate divestment plan had been approved for 1996. The divestment decision should take advantage of favorable market conditions, reduce total real estate and mortgages holdings by another $1 billion and add greater certainty to the achievement of the rehabilitation plan objectives. Everything considered, there is clear evidence that the plan is being well managed. ▼

Q & A, *from Page 1*

Q Those who work within and for the life and health insurance guaranty system like to believe it is working well. Do you agree? And if not. where is there room for improvement?

A I've indicated that I think we have made the system work and by "we," I include, of course, the administrators of the various state associations, NOLHGA staff, state board members -- from both the insurance industry and the public -- and the receivership community that we have come to work with very closely. Let me distinguish between improvements in the guaranty association laws and improvements in the system. NOLHGA began to revise the NAIC Model Act to clarify and make technical improvements over a year ago. That project is now in the hands of the ACLI, with NOLHGA continuing to assist, and should be going shortly to the NAIC for study and action. It will improve the act by removing ambiguities both in administration and benefits. The basic structure of the coverage of life and health insurance and annuities will remain unchanged. Of course there is always room for improvement -- one example I alluded to earlier is the acceleration of closure of estates. Much headway has already been made over the last two to three years in this area. The receiver's cooperation is critical and our relationship with the International Association of Insurance Receivers will help in this regard. The new Interstate Compact Commission may also prove to be helpful as the number of states joining the compact grows. We will continue to educate our administrators about ways to make the system more efficient.

Q Do you see a time when there will be no more life and health insurance insolvencies?

A I doubt that even the most zealous regulator of financial institutions, be it state insurance commissioner or federal banking regulator, believes there will ever be an absence of financial failures. A free-market economy is based on the principle that the opportunity to succeed carries with it the risk of failure. I don't see that principle changing for insurers just because they are highly regulated. Regulators can't control economic cycles that affect financial institutions nor the unanticipated effects they may have on every company, and even the best aren't able to prevent the clever crook, or the marginal operators. The risks our companies take on today are vastly more difficult than the risks we had in the 1960s and 1970s. It is far more difficult to manage a company profitably today, and the temptation is always there for companies to enter markets where they have little experience or expertise. ▼

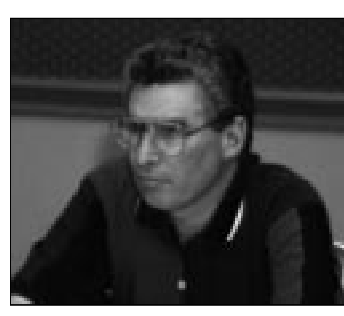
Administrator Profiles

RICHARD P. COOLEY, EXECUTIVE DIRECTOR
Connecticut Life and Health Insurance Guaranty Association

Mr. Cooley has been executive director of the Connecticut guaranty association since 1984. He was employed for 37 years by the Travelers Insurance Company. Mr. Cooley is a director of several guaranty associations and has been active in guaranty system activities since the Connecticut guaranty association was established in 1972. He is a graduate of Indiana University School of Law.

JOHN F. FALKENBACH, EXECUTIVE DIRECTOR
Delaware Life and Health Insurance Guaranty Association

Mr. Falkenbach has been executive director of the Delaware guaranty association since 1993. He is also a principal of Woody & Falkenbach, a Media, Pa., general practice law firm. Before establishing the firm, Mr. Falkenbach was vice president, secretary and general counsel of Continental American Life Insurance Company, a Provident Mutual company. Prior to that, he was counsel for CIGNA Corporation. Mr. Falkenbach graduated from Drexel University. He received his law and master of law degrees from Temple University.



WILLIAM E. FALCK, EXECUTIVE DIRECTOR/GENERAL COUNSEL
Florida Life and Health Insurance Guaranty Association

Mr. Falck has represented the Florida guaranty association since 1982. He is a member of the MPC Executive Committee and has served as chair or a member on more than 30 insolvency task forces. Mr. Falck is also general counsel for University Medical Center at Jacksonville and has served as an instructor in business law and health law at Belmont Abbey College and two Florida universities. He served six years on the staff of the Florida Supreme Court. Mr. Falck graduated from Florida State University and received his law degree from the University of Florida.

MICHAEL C. MARCHMAN, ADMINISTRATOR
Georgia Life and Health Insurance Guaranty Association

Mr. Marchman is also administrator of the Georgia Insurers Insolvency Pool and vice president of Marchman-Steele Agency, Inc., formed in 1984 to provide services for the insolvency pool. The guaranty association operations were combined in 1991 at the request of the Georgia Department of Insurance. He is a director of the International Association of Insurance Receivers and serves on many committees for NOLHGA, the NCIGF, IAIR and the NAIC. Mr. Marchman attended Georgia Southern College.

KENNETH L. SCARBOROUGH, EXECUTIVE DIRECTOR
Hawaii Life and Disability Insurance Guaranty Association

Mr. Scarborough was appointed executive director of the Hawaii guaranty association Aug. 1, 1994. Before working as a consultant to the Hawaii insurance commissioner from 1991-1993, he spent 11 years with Hawaiian Life Insurance Company, which merged in 1992 into Pacific Guardian Life Insurance Company. Mr. Scarborough was a lieutenant colonel in the Marine Corps when he retired in 1977 after 23 years and began law school. He is a graduate of Baylor University, has an MS from American University and a law degree from South Texas College of Law.

MEMBERS' PARTICIPATION COUNCIL

June 24-26	Peabody Hotel, Memphis
Sept. 9-11	Westin Hotel, Indianapolis
Dec. 3-5	Hyatt Regency, Denver

BOARD OF DIRECTORS

April 30	McLean, Va.

FOURTH ANNUAL LEGAL SEMINAR

Aug. 19-20	Stouffer Renaissance Stanford Court Hotel, San Francisco

ANNUAL MEETING

Oct. 28-30	Stouffer Renaissance Hotel, Baltimore

Visit the NOLHGANet home page at http://www.nolhga.com. Call Marcy Dausch at 703/318-1164 for more information.

National Organization of Life and Health
Insurance Guaranty Associations
13873 Park Center Road ■ Suite 329
Herndon, VA 22071